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SUBCHAPTER III. COST REIMBURSEMENT CONTRACTS

When it has been decided that the nature of the work or the unreliability of the cost estimate make it necessary to use a cost reimbursement contract, the contracting officer and the contractor have several choices. This section discusses two types of cost reimbursement contracts. First, the basic type of cost reimbursement contract -- the cost plus fixed fee contract - will be reviewed. We will then consider the various types of cost sharing contracts that have been used when the parties desire to share the risks on the contract by entering into an agreement that provides for cost sharing throughout performance of the work. Cost plus incentive fee and cost plus award fee contracts are dealt with in the section on incentive contracts. Cost reimbursement term type contracts are covered in the section on level of effort contracts.

FAR 16.301-3 provides three limitations on the use of any cost reimbursement contract as follows:

> A cost-reimbursement contract may be used only when --
>
> (a) The contractor's accounting system is adequate for determining costs applicable to the contract;
>
> (b) Appropriate Government surveillance during performance will provide reasonable assurance that efficient methods and effective cost controls are used; and
>
> (c) A determination and findings has been executed, in accordance with agency procedures, showing that (1) this contract type is likely to be less costly than any other type or (2) it is impractical to obtain supplies or services of the kind or quality required without the use of this contract type (see 10 U.S.C. 2306(c), 2310(b), and 2311 or 41 U.S.C. 254(b), 257(b), and 257(a)).

The third limitation merely repeats the statutory requirement that determinations and findings be executed. However, the required findings are of little significance since they require a forecast of future events. More useful guidance is now contained in FAR 16.301-2 stating:

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> Cost-reimbursement contracts are suitable for use only when uncertainties involved in contract performance do not permit costs to be estimated with sufficient accuracy to use any type of fixed-price contract.

The feature which all cost reimbursement contracts have in common is the Limitation of Cost clause, FAR 52.232-20. This clause overrides all of the contract requirements by providing that when the contractor has fully expended

the funds included in the contract, there is no further obligation to continue performance or incur costs, but that when the Government provides additional funds, the contractor must continue performance as long as funds are available until completion of the specified work. The clause provides, in addition, that the contractor must give notice of overruns and that the Government has no obligation to provide such additional funding or to reimburse the contractor for costs incurred in excess of the contractual amount. This latter provision has been quite strictly enforced to deny contractor's reimbursement of cost overruns not approved by the contracting officer in writing, ITT Defense Communications Div., ASBCA 14270, 70-2 BCA p 8370 (1970); American Standard, Inc., ASBCA 15660, 71-2 BCA p 9109 (1971). In the most liberal case on this issue, the Court of Claims found that an overrun had been funded when a contracting officer indicated approval of the funding on an internal memorandum which was not communicated to the contractor, General Electric Co. v. United States, 188 Ct. Cl. 620, 412 F.2d 1215, mot. for rehearing denied, 189 Ct. Cl. 116, 416 F.2d 1320 (1969). In making the decision on whether to fund the overrun, the contracting officer has great discretion. Hence, a choice can be made either to fund or not to fund the overrun after the costs have been incurred, Eyler Associates, Inc., ASBCA 16804, 75-1 BCA p 11,320 (1975); ARINC Research Corp., ASBCA 15861, 72-2 BCA p 9721 (1972). However, a decision not to fund the overrun based entirely on the failure of the contractor to give notice of the overrun as required by the clause may lead to difficulty. It has been held to be an abuse of discretion to make such a decision in a situation where the contractor could not have learned of the overrun, General Electric Co. v. United States, 194 Ct. Cl. 678, 440 F.2d 420 (1971). However, a stringent test has been used to determine if the contractor could have learned of the overrun in such circumstances, and it has been held that he can meet this test only by showing that a fully adequate accounting system would not have revealed the overrun, Stanwick Corp., ASBCA 14905, 71-1 BCA p 8777, mot. for reconsid. denied, 71-2 BCA p 9115 (1971). The Government has also been estopped from denying overrun funding where it told the contractor funds were available and observed the occurrence of the overrun, American Electronic Laboratories, Inc. v. United States, 774 F.2d 1110 (Fed. Cir. 1985).

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It has also become quite common practice to include ceiling amounts at the inception or during performance of cost reimbursement contracts. If such provisions are carefully drafted to provide that they establish ceiling prices and that the contractor is obligated to complete the work, they will be enforced, LSi Service Corp. v. United States, 191 Ct. Cl. 185, 422 F.2d 1334 (1970); National Civil Service League v. United States, 226 Ct. Cl. 478, 643 F.2d 768 (1981). However, in less clearly drafted clauses, the contractor has been permitted to avoid the ceiling, Singer - General Precision, Inc. v. United States, 192 Ct. Cl. 435, 427 F.2d 1187 (1970) (cost allocated to overhead as bidding expense); General Dynamics Corp. v. United States, 229 Ct. Cl. 399, 671 F.2d 474 (1982) (termination clause interpreted with ceiling permitting reimbursement of costs up to ceiling after default termination but making contractor responsible for excess costs of reprocurement).